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## NOTES

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### ELASTIC CURRENCY AND THE MONEY MARKET

The arguments in favor of a bill to establish an elastic currency failed to produce legislation in the session of Congress just closed; nor is this result to be wondered at, if the validity of the arguments sometimes proposed be closely examined. While the necessity of having the means of expanding and contracting our bank-issues is highly important for certain conditions and districts, it is obviously undesirable to assume that an increase of a bank's demand obligations is as effective as an increase of its resources; or, that exchanges are carried on in this country only by the use of bank-notes.

It cannot be too emphatically repeated just now that laws, which would enable a city bank to issue more of its own notes, would not thereby increase one whit the amount of its reserves, and consequently would not increase one whit its ability to make discounts to borrowers. When banking institutions have absorbed their funds in carrying large loans to railways, or to industrial syndicates, the only way they can meet the varying and legitimate demands of the merchant and manufacturer for loans based on exchanges of goods is by introducing more capital into the banking business; or by making less use of existing banking capital in promotions, or in other speculative operations, which are more or less removed from the usual demands of business. And it should also be emphatically repeated that a high and changeable rate of interest at the banks is an indication, not necessarily of a scarcity of money, but of a scarcity of capital in the loan market. Therefore, when a sensitive and high rate of interest in New York is referred to as a reason why our currency system is dangerously inelastic, the claim has very little, in principle or fact, to support it.

Although interest is paid for capital, which gives control over purchasing power, the function of money, while important, is really secondary. In this case, money only serves as a medium of exchange to transfer capital from the lender to the borrower. Anything which serves as a medium of exchange, whether gold, bank-notes, or checks, will serve to convey the capital to a borrower. In truth, if a bank has capital to lend, there is little real trouble

in finding means to transfer it to a customer. In New York, a deposit account as the result of a loan, and a check on that account, serve the whole purpose. In making loans to its usual customers, a New York bank has no more need of greater issues of its own notes than a wagon has of a fifth wheel. Its own notes are needed only in cases where a customer could not make use of a check on a deposit-account.

Obviously if a bank can increase its reserves, it can in due proportions increase—as a result of loans—its demand liability in the form of deposit accounts. This is now freely permitted. No legislation is needed to enable this to be done. But if a bank were given the power by new enactments to increase its notes and if it were obliged to protect these note liabilities by fresh reserves (as in the bills recently proposed in Congress), it would have no greater ability to loan than before. In our financial centers, where we have recently heard a violent clamor for more circulation, an increase of bank-notes would not increase the lawful money usable in reserves; and if issued, it would increase the demand liabilities just as would an increase of deposits.

What we have witnessed in the money market during the recent collapse of stocks in New York is an illustration of the above principles. The outcome was in no way due to a scarcity of money, but, if not due to lack of capital, it was wholly due to questions relative to the kind and value of collateral carried by the banks. If the collateral had been good, and additional loans were wanted on their security, then more reserves of lawful money were needed. Hence, the usual appeals to the Treasury in times of emergency, to put out—not more bank-notes but—more lawful money. If the collateral was not sound; if the banks had been carrying swollen securities marked up to fictitious prices as in the case of the Union Pacific; and if the banks at the same time, had demands for loans based on legitimate movement of goods from seller to buyer—there were but two alternatives. In the first place, the banks might turn more capital into banking, in amounts sufficient to carry all their business on increased reserves; or, in the second place, they could drop their speculative customers, and thus safely carry their legitimate loans. As it happened, the latter alternative in all probability was chosen by the New York banks. The enlargement of old business concerns, and the opening of new ones, the development of new resources, and the unparalleled extension of trade in the United

States have brought us to the limit of our available capital; and foreign capital, through such devices as finance bills on Europe, could at present no longer be drawn upon. Clearly, then, the banks could not expect to obtain more capital at once, even if all the demands upon them had been legitimate.

As the fall in the stock market has shown us, however, some of the collateral was undoubtedly not worth the high prices established; and, when the banks as the only wise alternative, were obliged to call their loans based upon this questionable collateral, the lending institutions returned to a sounder basis of credit and placed themselves in a position where the general business public could receive better accommodation. The result is one which, while reached only by drastic treatment, is unmistakably healthier and safer than the condition before the disturbance. The emetic has been given; and the patient has been purged, much to his advantage.

It is needless to say, therefore, that the late débacle could not have been prevented by the existence of an elastic asset currency. The essential evil was in the kind of loans made—i. e., the kind and prices of collateral used—and the evil could have been accomplished through the means of granting to the borrower either a deposit account, or the banks own issues (had the latter been possible). It is not the special weapon used to kill, which is to be held responsible, but the assassin who wielded the weapon. It is not the special liability in the form of a deposit, or of a note, which is dangerous, but the character of the loan which gives rise to the consequent liability.

J. LAURENCE LAUGHLIN

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## THE MARGINAL PRODUCTIVITY THEORY OF DISTRIBUTION

The two main propositions of this theory are, that each agent of production creates a distinguishable share, and that each gets what it creates.<sup>1</sup> The first question we have to answer, therefore, is, whether or not there are distinguishable shares in production. In order to simplify the problem, we will confine our attention chiefly to labor and wages.

According to the theory under consideration, there are two marginal zones of production, the extensive and the intensive, where labor creates the whole product, all of which goes to labor. The

<sup>1</sup> J. B. Clark, *Distribution of Wealth*, p. 3.